IN THE

# UNITED STATES CIRCUIT COURT OF APPEALS

## FOR THE NINTH CIRCUIT

FRANK P. McKINNEY, as Receiver of the OLYMPIA BANK & TRUST COMPANY, a Corporation, Appellant,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA, Appellees,

and

C. S. REINHART and C. WILL SHAFFER, Stockholders of OLYMPIA BANK & TRUST COMPANY, a Corporation, for Themselves and All Other Stockholders of Said Company, Appellants,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA, Appellees,

and

ROY A. LANGLEY, as Receiver of the STATE BANK OF TENINO,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA, Appellees.

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APPELLEES' BRIEF

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FREDERICK BAUSMAN,
ROBERT P. OLDHAM,
ROBERT C. GOODALE,
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SHERMAN PRINTING AND BINDING CO., SEATTLE, WASH.

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## STATEMENT OF THE CASE

*As between Receiver McKinney and Intervening Stockholders, and Appellees.*

This is an action brought by McKinney as receiver, on three separately stated causes of action (Tr. p. 5), as follows:

FIRST: For $36,550 alleged to have been transmitted by the Olympia Bank to the United States National Bank at Centralia, for the purpose of deceiving the National Bank Examiner, who was then examining the United States National Bank.

SECOND: On account of $10,000 alleged to have been sent by the Olympia Bank to the State Bank of Tenino, at the request of the United States National Bank.

THIRD: For $9,500 in notes, charged by the United States National Bank against the Olympia Bank & Trust Company, and deducted from its account, which notes the appellant receiver says should not have been charged to his institution.

The trial court held in favor of Receiver McKinney on the third cause of action, and in favor of appellee, receiver of the United States National Bank of Centralia, in the first and second causes of action, and on appellant's prayer for an accounting allowed

appellants the amount of certain admitted credits due the Olympia bank from appellee bank.

The first cause of action, if regarded as stating any lawful ground of recovery, involves the validity of a credit of $48,000 purported to have been given to the Olympia bank by our bank at Centralia, at the time of the organizing of the Olympia bank; for the remittance of $36,550 referred to in plaintiff's complaint (Tr. 8) is only substantiated by proof of the delivery of drafts drawn in the name of the Olympia Bank & Trust Company for the purpose of cancelling or offsetting the previous book credit.

It is appellees' contention that this purported credit was based on a wrongful and fraudulent plan entered into between one Hays, formerly of Olympia, Washington, and C. S. Gilchrist, Vice-President of the appellee bank, by which Gilchrist, secretly conspiring with Hays, attempted to lend the credit of the United States National Bank of Centralia, the appellee, to a newly organized institution, of which appellant, McKinney, was subsequently appointed receiver.

When the Olympia bank was organized by Hays and the other appellant intervenors, its capital stock, it appears, was only "orally subscribed" (Supp. Tr. 234, 145, 547, l. 28). Many of the members who had offered to take stock in the bank being unable to be present at the organization meeting, $36,500 worth of

stock (or about two-thirds of the whole) was directed to be issued in Mr. Hays' name, with the understanding that it should be distributed among the persons who had agreed to take it (Supp. Tr. 547).

None of the subscribers actually paid for their stock, except two, who paid in the amount of $2,000, leaving $48,000 unpaid. All except Hays, however, executed notes for the amount of their stock, payable on demand to the order of themselves and endorsed the same and delivered them to Hays. They say they understood Hays was going to lend them the money to pay for their stock, but they all admit they had never inquired whether he had ever done so, and that none of them ever paid anything on their stock. Nearly all of them admit that their notes were not bankable paper (Supp. Tr. 335); that they were not worth their face, or that they do not know what their notes were worth, if anything (Supp. Tr. 178), and that they were unable to pay them at the time the notes were given (Supp. Tr. 199), and have never paid anything on them, principal or interest (Supp. Tr. 179, 276, 327).

Mr. Howell, Vice-President, testified that he had a talk with Hays, and Hays told him that he wanted to use Mr. Howell's note for his stock subscriptions, just for a few days, until the bank should be opened (Supp. Tr. 315). Though borrowing from the new bank (Supp. Tr. 327, 328), he paid nothing on the note.

Under these circumstances Gilchrist and Hays, with Daubney, who assisted Gilchrist in the fraudulent transaction, meet at Hays' house, where they agree that the United States National Bank shall at once give the Olympia bank a credit for $50,000 against the capital stock of the latter institution (Supp. Tr. 230). The following then occurs, as Hays, who came from Montana voluntarily to testify as a witness for appellant McKinney (Supp. Tr. 132), very reluctantly admits (Supp. Tr. 230, 604, 605). Gilchrist agreed to advance the necessary funds *upon the stock of the Olympia bank* (Supp. Tr. 230):

> "Q. And finally you did arrange to get a credit on the capital stock?
> A. Yes.
> Q. And then you gave these notes as a sort of form in connection with that arrangement on the capital stock?
> A. Yes.
> Q. Then Mr. Hayes, at the time those notes were made up, you knew, Mr. Gilchrist knew, and it was recognized on all sides that as your notes, even if you had intended to make them as your notes, they would not have been of any value?
> A. Well, of course he wouldn't take my personal note for thirty-six thousand dollars.
> Q. You knew that perfectly well?
> A. Yes, sir.

Gilchrist, the officer of our bank who did this wrong, is asked (Supp. Tr. 488):

> "Q. At that time did you or did you not know of [that] the notes of Hays, if personal, if

simply taken as Hays' obligations, were worthless?

A. Yes, sir.

Q. Did you receive any money for the United States National Bank or any thing of value for that credit of $50,000; if so, what?

A. I didn't receive any money, no, sir. I received stock of the Olympia Bank & Trust Company."

Again Hays of the Olympia Bank is asked (Supp. Tr. 231):

"Q. In other words, upon your books you charged the capital stock of the Olympia Bank & Trust Company as well as "undivided profit" of five thousand to the United States National Bank?

A. Yes, sir."

(Supp. Tr. 604, 605):

"The bank, through Mr. Daubney and Mr. Gilchrist, *had agreed to take this stock and keep it until it was finally disposed of.* They had made final arrangements, agreements were made and entered into *just at that time, however, Mr. Gilchrist made mention of the fact that that was in strict violation of the law,* that they couldn't handle the stock in that manner, *and in order to avoid that they took the stock with those notes."*

Clearly the Hays notes were a sham. The substance of the transaction was a credit to the Olympia bank upon its capital stock. But while there is some apparent self-contradiction in Hays' testimony, he finally admits, and Gilchrist testifies very clearly, that, in fact, in so far as the notes had any reality at all in relation to the fraudulent scheme, the understanding was that whether they were signed by him individually or as cashier of the Olympia bank (a point on which

Hays was uncertain), (Supp. Tr. 172), they should not be treated as personal obligations of his own, but should be an obligation of the Olympia Bank & Trust Company, which it was expected could be paid out of the receipts of the Olympia Bank from the sale of capital stock (Supp. Tr. 569, 146, 146). Gilchrist testified that it was positively agreed that our bank might charge these notes back to the Olympia Bank & Trust Company at any time (Supp. Tr. 571, l. 24, 566, l. 13, 567, l. 4, 151).

As pay for his wrongful act in attempting to make it appear that the Olympia bank had a credit of $50,000 in the United States National Bank, it seems that Gilchrist was to be made an officer in the Olympia bank (Supp. Tr. 560), and that he had the option (Tr. 76) or privilege of buying Hays' controlling interest in the Tenino bank, at an agreed price.

Such being the situation, in pursuance of this understanding, *the entire corporate stock of the newly organized Olympia Bank & Trust Company was charged on its books* (Supp. Tr. 231) to United States National Bank, and United States National Bank was given credit for such amounts of cash as were actually paid for stock that was sold (Supp. Tr. 233).

On August 31, 1914, eleven days after the Olympia bank opened for business, $12,500 of the Hays notes were charged back to it in accordance with pre-

vious agreement, and the apparent balance created by the sham credit of $48,000 reduced by that amount (Supp. Tr. 571). Two weeks later, and a little more than a week before the Olympia bank failed, the fact that Gilchrist had attempted to finance the Olympia Bank & Trust Company was discovered by his board of directors (Tr. 113), and he told them that under his agreement with the Olympia Bank & Trust Company he had a right to charge back the entire remaining stock and notes and cancel the credit at any time, and his directors ordered him to do immediately (Supp. Tr. 457). This meeting was in the evening, and Gilchrist was sent at once to Olympia, and there called on Hays early the following morning, where Hays signed drafts in the name of the Olympia Bank & Trust Company to the amount of $36,550, a sum equal to the two notes given by Hays at the time the Olympia bank was organized. Gilchrist says that at that time he delivered to Hays the two notes and the stock (Supp. Tr. 567). Hays says that he then received only the stock (Supp. Tr. 155). The stock was found in the vaults by Receiver McKinney (Supp. Tr. 438), and there is strong ground for suspicion that Hays, who was tried on a criminal charge in connection with this very transaction, and who says he cannot remember whether the notes were signed personally or as cashier, destroyed them. The notes given by the other stockholders, aggregating $11,500, were found by Receiver Titlow

among the files of appellee bank, and their return to Receiver McKinney was demanded by intervenors (Tr. 26). They were accordingly tendered in open court to that receiver by appellee, by its answer to intervenor (Tr. p. 31), offered in open court to appellant, *and such tender accepted* by intervenors (Supp. Tr. 586, 587), though refused by appellant receiver!

## ARGUMENT

It is the contention of appellees that the intervenors have no standing or right to be heard in this cause, and that the only issues open to the consideration of this court are these arising under plaintiff's amended complaint.

As to these issues, plaintiff contends that appellant McKinney is entitled to recover nothing under his first cause of action for the following reasons:

FIRST: The purported credit, against which the charge complained of was made, was an attempt to lend the credit of a national bank to organize a state bank, and was beyond the powers of a national bank under Federal laws.

SECOND: The charge of $36,550 complained of gave rise to no liability to Olympia bank and its receiver for the reason that the same was not deducted from any real or actual balance existing in favor of the Olympia bank, but was merely a form to offset and can-

cel in part a false credit entered by Gilchrist, such original credit being invalid because the board of directors of our bank had never consented to the transaction, which was not in the ordinary course of business, was beyond the authority of its officers, and was based on a fraudulent conspiracy to which the Olympia Bank & Trust Company, through its cashier, was a party. The whole transaction between Hays and Gilchrist having been a fraudulent and wrongful one, the Olympia Bank & Trust Company and its receiver are estopped to set up the agreement to give credit to the Olympia bank, a cancellation of which forms the basis of plaintiff's cause of action, and a court of equity will leave the parties as it finds them.

THIRD: If there ever was a valid credit for $48,000 by reason of transactions between Gilchrist and Hays, it was by its terms subject to be cancelled and charged back to the Olympia bank.

I.

*The giving of the $48,000 credit by the United States National Bank to the Olympia Bank was ultra vires of the United States National Bank as amounting to a loan of its credit to the Olympia Bank for the purpose of starting it in business. It was therefore subject to cancellation at any time.*

Surely no more outrageous demand was ever as-

serted against a bank receiver, representing thousands of innocent depositors, than is here presented.

Certain persons desire to incorporate a bank in Olympia, but are without funds to finance it. Through their agent, Hays, they cause an officer of the United States National Bank to violate his duty to the depositors and stockholders of his bank, by falsely certifying that the Olympia Bank has $50,000 deposited with that bank, although, in fact, it has not one dollar so deposited. As a part of this transaction (though a mere sham, devised only to disguise the illegality of the real transaction) (Supp. Tr. 604, 605), the United States Bank takes into its possession the worthless notes of the incorporators of the Olympia Bank, as well as the worthless stock of that bank; later the United States Bank returns $36,550 of these worthless notes, and cancels to that extent the fictitious credit given. As to the balance of the notes, amounting to $11,450, the defendant receiver has disavowed any claim, and in his answer (Tr. 15) offered to return them to the plaintiff, thus completing the cancellation of the false credit.

A more obvious misuse of the functions of a national bank and a plainer transgression of the limits of its corporate powers can scarcely be conceived. The transaction most plainly falls within the inhibitions which the courts of the United States have clearly

defined against the prostitution of the powers and functions of National Banks to subserve private and other purposes lying outside the scope of their legitimate banking business. Here we have an officer of a national bank, certifying to a non-existent fact, pledging the credit of his institution for the purpose of assisting another institution conceived in fraud and entirely wanting in assets. This is not the case of a loan of *money* to an insolvent. It is a loan of *credit.* Now the bank could not lend its *credit* to any institution, however responsible. The fact of the beneficiary's insolvency only aggravates an offense which needs no aggravation to effectuate its perfect and entire illegality.

This Court is not a stranger to the doctrine for which we contend. In *Bowen vs. Needles National Bank,* 94 Fed., 925, your Honors had under consideration a case where a national bank advised plaintiff that it would pay all checks of a third person, although such person had no funds on deposit, as was known to both plaintiff and the bank. Plaintiff in reliance upon such promise, cashed checks of such third person. It was held that the bank was not liable upon drafts which it had issued in payment of such checks.

This case decided by your Honors was approved and followed in a similar case before the Circuit Court of Appeals for the 8th Circuit, in *Merchants Bank of*

*Valdosta vs. Baird,* 160 Fed., 642, which holds that a National Bank—

> "Cannot lend its credit to another by becoming surety endorser or guarantor for him. It cannot for the accommodation of another endorse his note or guarantee the performance of obligations in which it has not interest. Such an act is an adventure beyond the confines of its charter, and when its true character is known, no rights grow out of it, though it has taken on in part, the garb of a lawful transaction" (citing authorities) "An act that is void because beyond the powers of a National Bank, cannot be made good by estoppel" (citing authorities).

In the leading case of the *Commercial Bank vs. Pirie,* 82 Fed., 799 (C. C. A. 8th Cir), the defendant bank attempted to guarantee the payment by one Webb for any goods which he might purchase during a certain week. The Court says:

> "But it has never been supposed that the board of directors of a national bank can bind it by contracts of suretyship or guaranty which are made for the sole benefit and advantage of others. The national banking act confers no such authority in express terms or by fair implication, and the exercise of such power by such corporations would be detrimental to the interests of depositors, stockholders, and the public generally."

A similar case is *First National Bank vs. American National Bank,* 72 S. W., 1059, Mo., where the question of ultra vires with respect to such transactions is fully discussed and numerous authorities cited.

In *First National Bank vs. Hawkins,* 174 U. S., 364; 19 Supreme Court 739, it was held that a national bank is without power to purchase as an investment shares of stock in another national bank, and in case of the insolvency of the latter, the purchasing bank cannot be held liable to assessment upon the stock. The Court says (p. 742 Supreme Court Reporter):

> "If the previous reasoning be sound, whereby the conclusion was reached that, by reason of the limitations and provisions of the National Banking Statutes, it is not competent for an association organied thereunder to take upon itself, for investment, ownership of such stock, no intention can reasonably be imputed to congress to subject the stockholders and creditors thereof, for whose protection those limitations and provisions were designed, to the same liability by reason of a void act on the part of the officers of the bank as would have resulted from a lawful act."

Similarly in the case at bar, the stockholders and creditors of the United States National Bank are not to be subjected to loss by reason of the illegal acts of its officer. There is no reason to prefer the *plaintiff* over the *defendant* receiver, as the learned judge who tried this case below well says (Tr. 205).

See also *First National Bank vs. Converse,* 200 U. S. 425; 50 L. Ed. 537.

*Swenson Bros. Co. vs. Commercial State Bank,* (Neb.) 154 N. W. 233.

Observe that the stock in the Olympia Bank

handed to Gilchrist, being of no value, and it not being contemplated that the U. S. National Bank should have any rights in respect to it, was not *collateral* in any sense whatever. In fact Gilchrist seems to have become merely the depository of this stock, the intention being that it should be redelivered to the Olympia Bank as fast as it was sold, or the stockholders' notes paid up. But even if it had been security for the ultra vires undertaking of the U. S. National Bank, that contract would nevertheless be unenforceable.

*Seligman vs. Charlottsville National Bank,* Fed. Case No. 12642 (cited with approval by this Court in the Bowen case, 94 Fed. 928).
*Johnston vs. Charlottesville National Bank,* Fed Case 7425.
*National Bank of Brunswick vs. 6th National Bank,* 61 Atlantic, 889.

II.

*The original credit to the Olympia Bank was fraudulent and void.*

The transaction was much as if a manufacturer had arranged to ship to a mercantile firm packing cases, purporting to contain goods, but really empty, and conspiring with the merchants' shipping clerk, had induced him to agree to credit the shipper with an amount representing the value of the cases if filled. The credit having been entered in his company's books by the clerk who receives the empty cases, and dis-

covery being imminent, the cases are shipped back and the credit charged off by a counter-charge in equal amount. Can the company, whose empty cases are thus returned, hold the original consignee liable because the counter-charge indeed is founded only on the return of the same mere empty shells which the merchant had himself received?

With regard to the original transaction, Hays testified (Supp. Tr. 145):

"Q. You had it practically all subscribed for?
A. Yes.
Q. By other persons than yourself?
A. Yes.
Q. And you had not taken notes from all of those persons, had you?
A. No.
Q. Then in order to open the bank did you use any of the stock of the Olympia Bank & Trust Company?
A. Yes.
Q. What amount of stock of the Olympia Bank & Trust Company, if any, did you use in obtaining the credit referred to for the Olympia Bank & Trust Company?
A. About Thirty-six Thousand Five Hundred Dollars, near that.
Q. Did you ever obtain any personal or individual credit for anything in connection with that?
A. No, sir.
Q. Nothing ever passed through your hands individually, no money or credit ever passed through you individually in that transaction?
A. No, sir,—well you mean for that Thirty-six Thousand Five Hundred?

Q. Yes.
A. No."

(Our opponents claim that Hays personally borrowed $48,000 of us).

"Q. Well, as to that stock which had not been paid for, which you say had been asked for and not paid for, did you give a note signed by yourself as an individual transaction, of your note, or did you give it to accommodate the Olympia Bank & Trust Company in raising these funds or how did you give it, under what understanding did you give it?

A. I give it for the Olympia Bank & Trust Company in order to have this bank open.

Q. Was there any understanding as to whether or not you should be personally liable on those?

A. I wasn't to be personally liable.

Q. You were not to be personally liable on them?

A. No, sir.

Q. As between you and the Olympia Bank & Trust Company?

A. Well, as between me and the United States National Bank of Centralia, to whom I gave the notes.

Q. What was your understanding with the Olympia Bank & Trust Company with relation to that?

A. The understanding was that as the stock was paid for asked for, that it would be paid for and credited the United States National Bank of Centralia, and the stock returned to the purchaser.

Q. Were you doing that for the Olympia Bank & Trust Company then, is that what you mean?

A. Yes, sir.

Q. You regarded the transaction, the real transaction with regard to that capital stock and

the credit, your understanding was that there was a sort of loan of credit by the United States National Bank to the Olympia Bank & Trust Company, which was to be repaid in that way?

A. Yes, sir.

Q. Was that what the real transaction was according to your understanding?

A. Yes, sir."

As to credits to the U. S. National Bank, Hays is asked:

"Q. In other words, whenever you received any money from any one else than the United States National Bank in the payment for any stock of the Olympia Bank & Trust Company; you credited the United States National Bank with that item when you had already charged them with the whole capital stock, is that so?

A. Yes."

Gilchrist testifies:

"Q. What was that agreement, if there was such an agreement?

A. The agreement was to the effect that any of the arrangements that we finally made was simply a temporary arrangement on behalf of the Olympia Bank & Trust Company, and at any time thereafter or very shortly after, they got started that we would at any time be allowed to charge these notes back to the account."

(Supp. Tr. 566):

It was my understanding that he (Hayes) signed such a note and that they (directors of the Olympia Bank) had knowledge of the manner in which it was to be paid.

Q. And was that manner of its being paid, do you refer to the manner in which it was to be paid in your previous statement that it was to be charged to the Olympia Bank & Trust Company by you? (Supp. Tr. 567).

A. Yes, sir.

(Supp. Tr. 571).

I testified to the fact that the understanding between Mr. Hays and I was to the effect that any time it were necessary, we were at liberty to charge those notes to this account.
(Supp. Tr. 572).

The arrangement or agreement was made between myself for the United States National Bank and W. Dean Hays on behalf of the Olympia Bank & Trust Company.

The notes given were mere forms to cover up the transaction and make what was illegal in substance appear like a legitimate transaction (Supp. Tr. 230, 604, 605).

That Gilchrist who had already, as appears from Daubney's testimony, begun to incur the suspicion of his own Board of Directors, was in fact acting in his own private interest and not in the interest of his bank in entering this false credit, is finally brought out, and he himself *is finally compelled to admit he was promised a position as an officer of the newly organized Olympia Bank* (Supp Tr. 560):

Q. Was there any talk in connection with your transaction of the Olympia Bank of your being later made an officer of that bank?

A. "Well, Hays had suggested at one time, that he would like to have me associated with them in the capacity of an officer of the bank."

Q. *"Was that one of the things that was held out to you to occur in the future, was it or wasn't it?"*

BY MR. OWINGS: Objected to as leading.

BY THE COURT: Objection may be overruled.

BY MR. OWINGS: Exception.

A. "Yes, I may say that I had been spoken

to in regard to taking an official position in connection with affairs of the bank."

Gilchrist says that his principal motive in making this false entry of credit in favor of the Olympia bank was to assist Hays so that he would be able to take care of the Tenino bank (Supp. Tr. 529).

It will perhaps be contended by our opponents that this motive was one *for the benefit of the appellee bank* as well as for Gilchrist's benefit as purchaser of the controlling stock in the Tenino bank.

Even this suggestion must give way, however, for it clearly would have required but a small fraction of the credit extended to the Olympia bank, to have taken care of the Tenino bank, and the testimony of both Dysart and Gilchrist shows that in fact the United States National Bank had refused any further aid to Tenino, whose account was part of the time overdrawn and part of the time showed a small balance.

We respectfully submit to the court that the whole testimony shows that this false credit was entered through fraud and conspiracy, and without consideration, except a sham consideration of notes which were made as a mere form, and that for these reasons the decree of the court below should be affirmed.

Whether Hays had *authority* from the Olympia bank to perpetrate this fraud seems to us immaterial.

True, the President admits the unlimited leeway given Hays as follows (Supp. Tr. 242):

"Q. Did you,—do you recollect, Mr. Rhienhart, a resolution of the board of directors at the organization meeting, leaving to yourself and Mr. Hays the making of such arrangements as should be considered advisable to open the bank?

A. Yes.

Q. Did you undertake to make such arrangements?

A. There was scarcely anything, no sir, to be done at that time. Mr. Hays had, previous to all this, on his own responsibility, he had provided a room and gotten furniture and everything substantially ready to open. I simply, after that resolution, I acquiesced in the whole thing.

Q. *And went ahead and left it to him to open in whatever manner he arranged?*

A. Well, with the advice or the suggestions that I made from time to time, and about all the suggestions I made was with reference to keeping the books up. That wasn't complied with, however.

Q. You are familiar, however, with the fact that *the books do show that the capital stock of the bank was charged up to the United States National Bank of Centralia?*

A. *Why I have understood that is the fact, yes"* (Supp. Tr. 245).

"Q. *And you and everybody else regarded Mr. Hays practically as the Olympia Bank & Trust Company, isn't that so, leaving it to him to handle it and manage it and make its financial arrangements?*

A. Yes."

And the other intervening stockholders corroborate this testimony. At any rate, the stockholders and

trustees (for they are practically the same), are shown to have left all duties and responsibilities to Hays, and surely the Olympia bank is not in a position to seek in a court of equity the recovery of a profit or unearned credit through this transaction.

*Modern Woodmen of America vs. Union National Bank,* 108 Fed., 753, C. C. A., 8th Circuit; (certiorari denied, 21 Supreme Court Reporter 926).

Defendant bank held not liable for a sum of money which it had falsely certified that it had in its possession as belonging to the plaintiff, where such certification was made in the *bona fide* belief that the facts were known to plaintiff and that plaintiff would not be misled, though plaintiff was actually misled as a result of the certification. The Court says:

> "In the present instance it appears that the defendant bank did not have in its hands on December 31, 1895, any funds belonging to the plaintiff company; *that the credit given to it on that day was purely fictitious;* that it was given in reliance upon representations made by Smith that the plaintiff understood it to be fictitious, and upon the further assurance that the defendant should incur no liability by giving the credit. *It goes without saying that under such circumstances the law will not imply a promise to pay a sum of money which was never received."*

*Daubney's "Certificate of Deposit" and Hays' Attempt to Deceive the U. S. Bank Examiner."*

It will be remembered that it is shown that Daubney, cashier of the United States National Bank, signed an affidavit purporting to certify that the Olympia bank had $50,000 on deposit in his institution. This affidavit was admittedly made at Hays' residence, and was admittedly false at the time it was given, since no one claims that at that time anything whatever was actually on deposit in our bank to the credit of Olympia. *While there is no evidence that this certificate or affidavit was ever brought to the attention of the State Bank Examiner or otherwise actually used by the Olympia bank in any manner, or that it was ever shown to any person except Hays,* the question may naturally occur to the court whether this certificate in some way estops us from denying the validity of the credit, especially if the certificate was given with a fraudulent purpose on the part of Gilchrist and Daubney. There are, it seems to us, four answers to this suggestion:

*First.* The certificate, dated and given *at Olympia,* at a distance of thirty miles from United States National Bank, and not being a certificate of deposit or other evidence of debt which Daubney had any authority to sign in behalf of the bank, does not estop the bank from denying the credit. It will be considered purely

as an individual act of Daubney in his personal capacity. Any other rule would appear to be impossible.

*Second.* There is, as above stated, no evidence whatsoever that the certificate was in any manner used for the purpose of obtaining authority to open the bank or for the purpose of obtaining deposits.

*Third.* As suggested under another part of this brief (p. —), it not only does not appear that any part of the recovery demanded by appellant McKinney is required for payment of depositors or creditors of the United States National Bank, but, on the contrary, *it appears that the recovery already permitted is more than sufficient for the payment of all depositors of the Olympia bank in full,* and that a further recovery could only inure to the benefit of the stockholders, who are not entitled to assert estoppel against United States National Bank.

*Finally.* The whole question of estoppel to deny an apparent credit fraudulently inserted in either bank for the purpose of making the bank's position appear better than it really was, is immaterial in this case, because such claims offset each other. The drafts transmitted to the United States National Bank as Receiver McKinney himself alleges, for the purpose of deceiving the National Bank examiners, and by Olympia and charged to the Olympia bank as offsets to the original false credit of $48,000, put the Olympia

bank in precisely the same relation to the question of estoppel to deny credits issued for a fraudulent purpose, as is the United States National Bank. That is to say, if either bank is bound by the act of its officers in issuing false credits to the other, both are equally bound with the result that one charge offsets the other. In connection with this matter of offsets, too, it appears by the statements of counsel for intervenors that appellee bank is not able to pay its depositors in full, *and its receiver is thus in a position to claim against appellants all rights of estoppel existing in favor of innocent depositors;* while the contrary appears as to the receiver of the Olympia bank.

> *If Hays did lend $36,550 to the Centralia bank for the purpose of deceiving the bank examiner as stated in plaintiffs first cause of action, and his act was that of the Olympia bank, the illegality of the transaction prevents plaintiff's recovery.*

That such a transaction is illegal and that the law will leave the parties to it in the same situation in which it finds them, is too clear to require extended discussion or citation of authorities. The parties in such a case are in *pari delicto* and the law will aid neither.

The cases in which this doctrnie has been applied are numerous. Thus, in *Bryant vs. Wilcox,* 100 N. W. 918 (Michigan), the plaintiff gave defendant $500 which defendant was to exhibit to a creditor of one

Keith in order to convince the creditor that a certain mortgage, which the defendant held upon Keith's property, was much larger than it really was in order to defeat the claim of that creditor. Defendant failed to return the money and plaintiff sues to recover it. Held, that plaintiff could not recover. The court says:

> "By this testimony the money was placed in defendant's hands for the sole purpose of effectuating a fraud upon the creditors of Keith. The law will leave the parties to such a transaction where it finds them and will not, where both are equally culpable, engage itself to determine the right of the matter as between them."

In *Maryland Trust Company vs. National Mechanics' Bank,* 63 Atlantic 70 (Maryland), the plaintiff national bank loaned to the defendant trust company a large sum of money for the purpose of enabling the trust company to buy its own shares and to deceive the public by making it appear that there was a market for the shares, thus increasing their salable value. Held, that the money having been lent for an illegal purpose could not be recovered. The court says, page 78:

> "It is, generally speaking, true that a lender of money is not concerned with the purpose for which the borrower secures it; but when he does know, and is apprised that it is being borrowed for an illegal use, the situation is altered, and he becomes implicated as a participant in the unlawful transaction in furtherance of which the fund is used."

The Olympia bank in the present case (unless its contention that it is not responsible for Hays' act can be sustained) stands in precisely the same situation that the National Mechanics' Bank occupied in the case just stated.

In the leading case of *McMullen vs. Hoffman,* 19 Supreme Ct. 839; 174 U. S. 639, the Supreme Court of the United States declined to give relief to a party claiming a right to accounting with respect to transactions entered into as a part of a scheme to prevent bidding on public contracts. The court says:

> "The authorities from the earliest time to the present unanimously hold that no court will lend its assistance in any way towards carrying out the terms of an illegal contract. In case any action is brought in which it is necessary to prove the illegal contract in order to maintain the action, courts will not enforce it, nor will they enforce any alleged rights directly springing from such contract."

In *Bartle vs. Nutt,* 4 Pet. 184; 7 Lawyers' Ed. 825, a bill was filed to compel a partner in a contract for a public work, in which a public agent was to participate, to account. The court held that:

> "To state such a case is to decide it. Public morals, public justice, and the well established principles of all judicial tribunals alike, forbid the interposition of courts of justice to lend their aid to principles like this."

We need not enlarge upon this question further

than to call attention to the following additional authorities:

> *Primeau vs. Granfield,* 193 Fed. 911, certiorari denied, 225 U. S. 708 (no accounting between parties to scheme to sell worthless mining stock to innocent investors).
>
> *Reed vs. Johnson,* 27 Wash. 42.
>
> *Creath's Administrator vs. Sims,* 5 How. 192; 12 L. Ed. 111.
>
> *Logan vs. Insurance Co.,* 146 N. Y. S. 678, App. Div. (Loan of securities to insurance company to deceive insurance commissioner).
>
> *White vs. Cuthbert,* 41 N. Y. S. 818 (App. Div.)

## THE $36,550 ITEM SUBJECT TO VARIOUS CONSTRUCTIONS.

Our opponents make much of the charging of the $36,550 of Hays' paper to the Olympia bank, treating it as a payment by Hays of his individual obligations out of bank funds. We ourselves regard it as did the trial court, as a cancellation of a previous fraudulent unauthorized and *ultra vires* credit. As stated by the trial judge (Tr. 206):

> "* * * the future establishment and financing of another bank was such an extraordinary transaction as—when so secretly engineered by Gilchrist, to constitute a fraud upon the United States National Bank and other directors."

The trial judge then cites the statute requiring that the capital stock be paid in cash, and that such payment be certified under oath by the president, treas-

urer, or secretary of the newly organized institution, and says:

> "No part of this disputed item was ever paid in cash. What is claimed is that a credit was obtained in the United States National Bank for Hays' note, that is, a promise to pay cash on demand, which promise was, as the court has found, saddled with an agreement that Hays would, upon demand, charge off the credit given the Olympia Bank & Trust Company.
>
> The court found, upon the trial, in effect, that the $36,550 stock subscribed by Hays was, in no sense, paid, because the credit to the Olympia Bank & Trust Company, colorably given on account thereof upon the books of the United States National Bank, was secretly and fraudulently pledged, by agreement between Hays and Gilchrist, from the beginning. The fund represented by this colorable credit was, at all times, in the control and keeping of Gilchrist, as an officer of the United States Natinoal Bank, and Hays agreed to the charging off of this colorable credit at any time, which agreement he performed upon demand of Gilchrist, by giving drafts to that amount.
>
> "* * *
>
> "As Gilchrist was first vice-president and manager of the United States National Bank, counsel, in their petition for a rehearing, demand how it is that Dysart, the second vice-president, could assume to command Gilchrist to obtain from Hays drafts against this colorable credit, or otherwise secure its relinquishment. The only answer to that is that it must have been the righteousness of his cause for 'Doubly armed is he who has his quarrel just.'
>
> "If this credit had been more than colorable, such action upon the part of Dysart would have been reprehensible; but the court finds that it was not. The giving of the draft was but an effort

to remove a cloud created in fraud upon the funds of the United States National Bank."

It will be observed from the foregoing that the court below, who had the advantage of observing the demeanor of the various witnesses throughout the long trial, found not only a fraud against the United States National Bank which vitiated the paper credit of $48,000, but also an agreement or condition attached to the credit, which amounted substantially to a pledge of the credit as security for the debt through which it arose. Such an agreement is far from unusual in banking transactions. Another instance of it appears in this record in relation to the $5,000 Hays note. Frequently a loan is made under the condition that a certain proportion of the proceeds shall remain constantly on deposit with the loaning bank, and shall be subject at any time to be charged against the principal obligation. Borrowing on the capital stock does not, however, operate as payment of the stock in cash, and unless the officers of the Olympia bank had made certificate under oath that the entire stock had been paid in cash, the Olympia bank could never have commenced business. (Tr. 207.) The suggestion is made by our opponents that this was in some manner done by Gilchrist and Daubney. The statute is clear, however, that such certificate can only be furnished by the officers of the newly organized bank in their official capacity. There is no evidence that the affidavit

frequently referred to by our opponents as a certificate of deposit, signed by Daubney, was ever used in any manner whatever, or that it was ever seen by anyone except Gilchrist, Hays and Daubney.

*This an Attempt to Enforce an Executory Agreement.*

Admittedly the pretended credit of $50,000 was never actually withdrawn or attempted or permitted to be withdrawn. There was then in fact not a loan or advance, but at most a mere agreement or attempted agreement to make a loan. If such a thing may be enforced against a national bank there is no limit to the hazards to which national bank capital and national bank deposits may be subjected. A score of newly organized concerns may turn up at once saying that a reckless or dishonest bank officer has agreed to advance them enormous credits upon their capital stock. There is no limit to the thing, and distinction between an *ultra vires* underwriting or loan of credit by a national bank and the ordinary loan or discount of paper must be based on the *real nature of the transaction, as distinguished from its form.* If this transaction was a *bona fide* discount of Hays' paper by our bank in the ordinary course of business, it should stand. If an attempt to have the United States National Bank secretly finance the Olympia Bank & Trust Company, it must fall.

## THE $48,000 FALSE CREDIT—SUMMARY.

Looking at the matter in a broad way, it seems to us that there are two possible conclusions as to the real nature of the transaction between the two banks by which the wrongful credit of $48,000 was attempted to be given:

1. It may be considered that Hays, as he himself says, was known to his directors and fellow-promoters not to be putting up actual money for his stock, and that he was directly or indirectly authorized by them to effect substantially the arrangement that he did effect for a temporary credit in anticipation of the promoters being able to collect payment for the stock in behalf of the Olympia bank from other persons who had agreed or expressed some willingness to take it. Should the court adopt this view, there would seem to be no room for debate as to the credit being fraudulent and void as against appellees.

2. It may be considered that the directors of the Olympia bank, without making inquiries as to Hays' financial responsibility or even looking up his commercial rating (Supp. Tr 334), believed that he would and supposed that he did pay out of his own funds substantially the entire capital stock of the Olympia Bank & Trust Company. As against this hypothesis must be considered, first, the fact that the complete and absolutely illegal underwriting of the stock of the Olympia

bank by appellee bank appeared on the face of the books of the Olympia Bank & Trust Company, and was admittedly known to several of the directors, as well as fully open to the inspection of all. It seems impossible to suppose that in a small community like Olympia such a fact, known to Reinhart and Cavanaugh, who are shown to have been the friends if not the intimates of the other directors, should not have been known to all. The original minute book of the corporation which might lend some assistance in this connection is strangely missing, and we have only a copy of the minutes of a single meeting.

Having in mind the foregoing, as well as the testimony of Hays that at or immediately after the transaction Mr. Howell congratulated him on bringing his negotiations with Gilchrist to fruition (testimony which Mr. Howell does not take the stand to contradict); and that Hays, appellants' witness, testifies very positively that he informed several members of the board what he was doing, we submit that no court should reverse the finding of the trial judge to the effect that the Olympia bank itself, as distinguished from Hays, is at least as much at fault as appellee bank, and that its receiver and stockholders are not in a position to recover on account of this transaction in a court of equity.

But even assuming a finding that the directors of the Olympia bank put such blind confidence in Hays

that they never even inquired as to whether he had paid in his enormous stock subscription, which their own record shows they knew was not all made in his own behalf (Supp. Tr. 188), and assuming that they closed their eyes to the plain record of this illegal source of credit as it appeared upon their own books, no concealment of which was made (Supp. Tr. 251, 252), we say that it seems impossible that this corporation, or its stockholders and directors, can be relieved from a finding of gross neglect of duty, and we submit that upon the facts shown, they are charged with and estopped to deny knowledge of the facts which they could so easily have obtained.

## INTERVENORS HAVE NO RIGHT TO BE HEARD AND THE ACTION SHOULD BE DISMISSED AS AGAINST THEM.

The petition of the intervenors appears to us quite anomalous and improper. Here is a suit brought by one claiming to be receiver of a corporation. With somewhat naive frankness the intervenors say that they intervened in the case and presented their intervening petition *that the court might consider certain claims which were deemed inconsistent with plaintiff's cause of action!* (Intervenor's Brief, p. 3.)

In other words, the following is the situation: The officer appointed to administer the estate of this insol-

vent bank being put to an election of remedies or having choice as to the affirmance or disaffirmance of certain transactions, elects to seek certain remedies and brings an action. Can the court tolerate for a moment the idea that any stockholder who conceives that his private interests or the interests of the estate would be subserved by a different election or by the pursuit of inconsistent remedies by the receiver is at liberty to intervene as a party plaintiff in the cause and demand that the defendant answer his complaint and defend against a different claim? If stockholders possess such a right after insolvency of the corporation can they not equally claim the same privilege while the corporation is actively engaged in business? The thing seems to us an absurdity and one which if given contenance by this court would result in intolerable confusion in future litigation.

There is no showing of any reason or necessity for the intervention of the intervenors of this suit. The insolvent bank was represented by its receiver, who at the time of his appointment, at least, was the properly constituted officer, under the State Law, for the bringing of such suits.

It is made the duty of the receiver of the bank under Rem. and Bal., Sec. 3305, under which Plaintiff was appointed:

"To wind up the affairs and business thereof

> for the benefit of its *depositors, creditors,* and *stockholders.*"

The receiver is thus made expressly, by statute, the representative of the stockholders, as well as of the creditors of the bank, and the statute does not contemplate that each stockholder shall come in and represent himself. The intervenors are therefore barred by this fact, as well as by their unclean hands, from asserting any of the claims which they now attempt to set up.

In *Wenar vs. Schwartz,* 44 So. 902 (La.), a stockholder intervened in opposition to the claim of a creditor against a corporation which was in the hands of a receiver. The court held that the stockholder had no right to intervene, upon the ground, among others, that:

> "Where a corporation is in the hands of a receiver and hopelessly insolvent, one of its stockholders has no interest and no standing for interfering in the judicial settlement of its affairs."

Nor does the termination of the receiver's powers by the statute of 1915, referred to on p. — *post,* if such is the effect of the statute operate to authorize the maintenance of this action by the intervenors. It merely substitutes the State Bank Examiner as liquidating agent, and rests all powers in him.

We pray that the decree be affirmed as against the intervenors, with costs, upon the simple ground that they have no standing before the Court in this suit.

*The Inequity of Further Recovery in This Cause by Plaintiff.*

Perhaps the action of plaintiff in voluntarily calling in additional counsel to represent both plaintiff and intervenors and in stating to the Court that there was no issue or dispute between intervenors and plaintiff (Supp. Tr. 4) may first suggest that this action is in reality being prosecuted not for depositors of the Olympia Bank, but for the profit of these intervenors, who, having paid not one dollar for their stock in this bank, now so loudly assert their right to recover something.

Appellee's solicitor stated to the court in the course of the trial (Supp. Tr. 280):

> "I want to show that in reality it is practically only the stockholders or principally the stockholders that are interested here, that this isn't an attempt to recover for the benefit of the creditors of the Olympia Bank, but is an attempt by these stockholders, either directly or through the receiver for their benefit, to recover money which they have no equity in and have no right and are not entitled to."

The record shows (Tr. 71, Supp. Tr. 279) that the total deposits of the Olympia Bank and Trust Company at the time of its failure amounted to about $44,000, and shows that of this amount about $30,000 was state deposits and that these have been fully repaid (Supp. Tr. 279, 280). It shows that on the remainder, dividends of ten per cent had been paid at

the time of the trial in the Court below (Supp. Tr. 279). The recovery of the plaintiff in the trial court in this cause was $25,998.91.

Intervenors in their brief (p. 51) state that the appellee bank is paying its creditors 50 cents on the dollar or thereabouts. Our own estimate is considerably in excess of this percentage, but even on that basis it appears that the amount available in the hands of the receiver, including cash on hand and unrealized resources, recovery from the State Bank of Tenino amounting to $10,000, recovery under the judgment of the Trial Court in this cause, and *even without* any recovery upon the surrendered notes of the intervenors, will far more than pay all creditors of the Olympia Bank & Trust Company in full, leaving a substantial balance for the stockholders of that institution.

*Neither Intervenors nor the Olympia Bank & Trust Company Come Into This Court With Clean Hands.*

In Intervenor's Brief (p. 13 and 14) is set forth the statute under which the Olympia Bank & Trust Company was attempted to be organied, which provides:

First, That the capital shall be *paid in cash* before the company shall be authorized to transact any business.

Second, That payment of the entire capital stock

in cash shall be certified to the bank examiner under oath by the president and treasurer or secretary of the bank which is being organized.

Third, That before the corporation shall be authorized to transact business other than such as relates to its formation and organization the bank examiner shall ascertain whether the requisite capital has been fully paid in cash, and if it appears that such capital stock has not been paid in cash the certificate of organiation shall not be granted, and such corporation shall not commence business until such certificate of incorporation has been granted.

Fourth, That when the certificate of authority is issued by the bank examiner the persons named in the articles of incorporation and their successors shall thereby and thereupon become a corporation * * *

Under these provisions it seems plain that the Olympia Bank & Trust Company was never lawfully incorporated and that such certificate as it obtained, purporting to authorize it to commence business, could only have been procured through the making of an affidavit by the intervenors, Reinhart and Shaffer, as president and secretary, respectively, that the capital stock had been paid in cash. Both Mr. Reinhart and Mr. Shaffer testified that they never even inquired whether any considerable part of the capital stock had been paid in (Supp. Tr. 178, 242), and didn't know whether it had been paid in (Supp. Tr. 180). Howell,

the Vice-President, says he made no inquiry whether it had been paid, and considered it none of his business (Supp. Tr. 323), and all admit that they had themselves paid no cash for their stock and that they never have paid for it to this day. (Supp. Tr. 327, 276, 180).

Admittedly, the appellant receiver now has the stock of the Olympia Bank & Trust Company to represent which Mr. Gilchrist undertook to give the Olympia Bank & Trust Company a sham credit (Supp. Tr. 438). The inequity of appellants' position from several points of view is thus plain. Is the thought to be tolerated that upon the facts shown in this record, stockholders who have actively organized a bank without capital in the teeth of the statute, and who by their utter negligence and disregard of the obligations placed upon them by law, have made possible the fraud through which all others have suffered, should recover the amount of a fraudulent and sham credit from a receiver representing the depositors of a bank whose directors never knew of or assented to the transaction?

The principal "stockholder," "Friend" Hays, admits on the stand his fraudulent conduct. And he has paid as much for his stock as any of the others, with the solitary exceptions of the bookkeeper and one other trustee. That in such a case the corporation itself is cut off from recovery in a court of equity is indicated by the authorities cited hereafter.

To state the case of these intervenors would seem to be to decide it. Both upon principle and authority, they are without standing in any court. They are not stockholders and have none of the rights of stockholders.

A case entirely in point upon this question is *Hinckley vs. Pfister,* 53 N. W. 21 (Wisconsin).

A statute of Wisconsin provided that stock must be fully paid for "to the amount of its par value." The plaintiff brought this action against the corporation and others, asking for a receiver and other relief, predicating his right upon his position as a stockholder, as well as asserting claims as a creditor. He also sought the cancellation of certain bonds of the corporation which were issued without the value which the statute required being given. As to plaintiff's right to the cancellation of these bonds, the Court says:

> "Besides, both the corporation and Hinckley, as its President, participated in the unlawful issue of them, and occupy no position to ask the intervention of a court of equity, for they could neither of them make out a title to relief, except by showing a plain and positive violation of the statute. They are in equal wrong with Pfister, the party to whom the bonds were issued. *Clarke v. Lumber Co.,* 59 Wis. 655, 18 N. W. Rep. 492, and cases there cited. The law will leave the parties as they are, affording a remedy to neither."

As to plaintiff's standing as a *stockholder,* the court says:

"In this view of the case, the plaintiff's stock, as well as that issued to Hinsey and others, falls under the condemnation of section 1753, *and is void, as not having been fully paid for 'to the amount of its par value,' so that neither of them can make any claim by means of or through it to the aid or protection of a court of equity as against the other, based upon the rights of a stockholder.*"

Another case bearing directly upon this question is *Arkansas River Land Company vs. Farmers' Loan & Trust Company,* 22 Pacific 954 (Colorado). In this case certain alleged stockholders in a corporation brought a suit against it and other parties, to restrain the carrying out of a contract by the corporation with the other defendants. None of the plaintiffs had paid anything for their stock.

The Court states the question presented thus:

"The naked question presented is whether these parties, as holders of 4,000 shares of fictitious capital stock, are shareholders of the company, and in a position to entitle them to be heard in a court of equity."

And again on the same page:

"Plaintiffs could maintain this action only by showing that they were shareholders, and vested with contract rights, of which the stock certificates issued to them were the evidence, which they could enforce against the corporation itself. This they have utterly failed to do. On the contrary, by the express allegations of the complaint *it appears that they acquired the stock, not only in fraud of the rights of the corporation, but in express violation of the constitutional mandate of the state, and*

*of the provisions of the law under which the corporation was organized.* The stock held by them is fictitious, within the meaning of the constitution, *and no rights can be predicated upon it, either in law or in equity."*

And again on the same page:

"They ask for an accounting, yet it does not appear that they or either of them ever expended a dollar which would constitute a legitimate claim against the corporation, or against the defendant. They ask that the bonds and the trust-deed be declared void, yet, by their own admissions, their interest in the corporate property is merely nominal. Throughout the whole of this extraordinary record of fraud and violation of law in the administration of the affairs of this corporation these parties appear first as promotors, and at all times as active participants in every illegal transaction. Counsel for plaintiff in error states in his brief that the court below dismissed the bill because *ex turpi causa non oritum actio.* The maxim was well and aptly applied. The judgment should be affirmed."

In *Minor vs. The Mechanics Bank,* 26 U. S., 46, 7 L. Ed. 47, the Court says, referring to a subscription to bank stock fraudulently made:

> "If the subscription were fraudulently made, with a view to evade the provisions of the charter, the law will hold the parties bound by their subscriptions, and compellable to comply with all the terms and responsibilities imposed upon them, in the same manner as if they were bona fide subscribers. It will not make the subscription itself a nullity, but it will deprive the subscribers of the power of availing themselves of the same."

We need not amplify citations on this point, but refer to *Clarke vs. Lincoln Lumber Company,* 18 N.

W. 492 (Wis.); 3 *Cook on Corporations,* 7th Ed., Sec. 735; *Coddington vs. Canaday,* 61 N. E. 567 (Ind).

This case holds, if authority be needed upon the point, that the acceptance by directors of *notes,* in payment of capital stock of a bank, is such misconduct as to render the directors liable to the bank's receiver.

Observe that these intervenors in the case at bar were also directors and officers of the Olympia Bank. The intervenors and other officers and trustees would appear in more nearly their proper capacity, as *defendants* in a suit by the receiver of their bank to recover against them for their negligence—to use the very mildest term—in mismanaging the corporation and taking worthless notes in payment of stock subscriptions, than as plaintiffs, attempting to make their own violation of the law the basis of this speculative endeavor to enrich themselves at the expense of Receiver Titlow's three thousand impoverished creditors.

In *Moses vs. Ocoee Bank,* 69 Tenn. 398, the court says: "This mode of transacting banking business (namely, accepting notes for stock, and similar misconduct) can have no countenance or recognition from the courts."

And the intervenors cannot conceal their own lack of equity by pretending to act here in the name of, or

on behalf of the corporation or other stockholders. The authorities already cited are sufficient on this point, but in passing we desire to call attention to the case of

*Home Fire Insurance Co. vs. Barber,* 93 N. W. 1024, Neb.,

holding that if corporate stockholders have no standing in equity to entitle them to relief in their own name, they cannot obtain such relief in the corporation's name, and, further, that if all of the stockholders are without standing in equity, *the corporation is also without standing, since in equity the court will not forget that the stockholders are the real and substantial beneficiaries of a recovery by the corporation.*

Applying these principles to the case at bar, it appears that the holders of $48,000 out of $50,000 of the stock of this corporation, paid nothing whatever, and that all of the stockholders were cognizant of, or at least fully charged with knowledge of the illegal and fraudulent character of the incorporation. One of the two stockholders who paid a small amount of cash (Cavanaugh) was the assistant cashier (Supp. Tr. 246) and a director (Tr. 94) and the other (Jones) was *chairman of the board of directors* (Supp. Tr. 189). If there was ever a case where a corporation or its stockholders were without standing to complain of a transaction in which the corporation was involved, it is this case.

*Olympia Stockholders Would Take Out the Mote From Their Brother's Eye.*

It is interesting and curious to observe the earnestness with which appellants complain that the directors of the United States National Bank should be charged with notice of this fraud through the entry on their books of a credit to the Olympia bank while they are shocked that any one should suggest either knowledge or negligence on the part of any of the Olympia directors or officers.

Let us test this broad distinction and see whether in fact these Olympia gentlemen are justified in attempting to place all the blame on the directors of the National bank and none upon themselves.

Is the fraudulent transaction then plainly set forth on the books of our bank and concealed on the books of Receiver McKinney's institution? Let us see. On page 157 of the Transcript of Record we find a copy of the entries on the books of the Olympia Bank with receiver's notations thereon. Here appears a charge to the United States National Bank, not of cash, not of a "remittance," not an entry in any way ambiguous or susceptible of misinterpretation, but in plain language *a charge of the entire capital and surplus of the Olympia institution to our bank* as follows:

"Capital and Undivided Profits $55,000."

Mr. Reinhart, president of the bank and intervenor herein, is asked (Supp. Tr. 242):

> "Q. You are familiar, however, with the fact that the books do show that the capital stock of the bank was charged up to the United States National Bank of Centralia.
>
> A. Why, I understood that is the fact, yes."

Director and Assistant Treasurer Cavanaugh is asked as follows (Supp. Tr. 251):

> "Q. You knew then from the entries which you were making that you were getting credit from the United States National Bank for the capital stock of the Olympia bank.
>
> A. Yes, sir.
>
> Q. But you did not know of any real money coming in from any source in payment of the capital stock, did you?
>
> A. Not except that which I, myself, paid in and that Mr. Jones paid in.
>
> Q. That amounted in all to about $2,000?
>
> A. Yes, subsequent to that there was other payments."

(The latter were of trifling amount and are credited to appellee by Olympia Bank & Trust Company.)

Your Honors might well perhaps have assumed that at least the corporate records of the Olympia bank are in perfect and regular form and were produced to sustain the transaction, but strangely enough it appears that the entire corporate minute book has been lost (Supp. Tr. 187, 201, 452). Though he thinks there were several, perhaps six, meetings of the board

of trustees of which no minutes whatever are produced, Mr. Shaffer, the Secretary of the Olympia bank, says that he "hasn't the best memory in the world" and that he does not remember a single thing that occurred at the other meetings (Supp. Tr. 191) and Hays is compelled to admit that he has previously testified that about the time or shortly after organization of the Olympia bank he had a conversation with Mr. Howell, its Vice President, and a member of its Board of Trustees, in relation to his negotiations with Mr. Gilchrist; that the conversation occurred in the bank shortly after the organization and that the substance of it was that in the matter of the negotiations with Mr. Gilchrist, Mr. Howell congratulated the witness for bringing it to a fruition (Supp. Tr. 601, 602, 603).

*No record of the fraud on appellee's books.*

Now not only is there not a line of evidence even tending to bring home guilty knowledge of this transaction to any member of the board, officers or employee of appellee bank except the two misguided and guilty officers who conspired with Mr. Hays, but it appears that the only entry on its books with reference to the transaction was that copied into the statement appearing on page 158 of the printed transcript of record, viz., *August 20, R. $48,000.00.* "R" stands for remittance (Supp. Tr. 108). Even the Hays' notes were not put in the note pouch but were evidently concealed

by Mr. Gilchrist until he returned them to Mr. Hays September 15th. One of them Mr. Gilchrist says he "charged to the Union Trust Company," but this was evidently a mistake. The account shows that neither the Union Trust Company nor anyone else was charged with this note on the books until the notes were charged back in the form of credits on the Olympia bank's draft which cancelled the principal part of the original false credit of $48,000. Then both the notes were returned to Olympia (Supp. Tr. 567).

## THE OLYMPIA BANK'S TENINO TRANSACTION.

The facts in regard to this transaction, which constitutes receiver McKinney's second cause of action, are simple.

W. Dean Hays, cashier of the Olympia Bank & Trust Company, was also vice-president (Tr. 97) and cashier and principal owner of the State Bank of Tenino (Supp. Tr. 61, 118). He entered into an agreement with Gilchrist, the Vice-President of the U. S. National Bank, under which Gilchrist intended or had the option (Tr. 76, middle of page) to buy Hays' interest in the Tenino bank. This transaction had not been consummated, however. Nothing had been paid on account of it (Tr. 76), and it was, in fact, never carried out (Supp. Tr. 135). But Hays had borrowed

money of the U. S. National Bank through the Tenino bank (Tr. 120, 78).

As to whether a balancing of accounts at that time would have shown an indebtedness in favor of the Tenino bank as against our U. S. National bank or vice versa is in dispute. The witness who seems to be regarded by all parties as most reliable, Mr. George Dysart, however, says that the Tenino bank was then in debt to the U. S. National Bank (Supp. Tr. 461). Gilchrist says the Tenino bank at any rate did not have to their credit an amount equal to the sum demanded (Supp. Tr. p. 532, line 28). And it elsewhere appears that the account was overdrawn at about this time (Supp. Tr. 513). Under these conditions it appears that Mr. Blumauer, acting manager of the Tenino bank, telephoned to Mr. Dysart and Mr. Gilchrist, Vice-Presidents of our bank at Centralia, and stated that the Tenino bank was greatly in need of funds, not having sufficient cash to meet the demands upon it even for a day. Mr. Blumauer says that he asked Gilchrist for funds and that Gilchrist said that he would take it up with Mr. Hays and have Mr. Hays take care of it (Tr. p. 84). The items were in fact charged to us in the Olympia Bank's ledger, which plaintiff admits was found utterly unreliable (Supp. Tr. 44, l. 29), but were not so charged on the Olympia Bank's books of original entry and do not appear in any manner on the books of the U. S. National Bank.

Receiver McKinney testifies (Supp. tr. p. 44):

"A. * * * What I meant is, there is nothing; there has never been any account opened with the State Bank of Tenino at all, and they really have not charged anything to them, *but the transactions there of course show that we did send some money to Tenino and should probably have a credit for it,* but, as I say, those items were charged to Centralia."

"Q. Then, really, all you could say about it would be that there was not a *ledger account* opened with the Tenino bank, and no *ledger charge* made?

A. Yes, that is what I meant to say, meant for you to understand.

Q. Then, isn't it a fact, Mr. McKinney, getting right down to the meat of it, *you found the books of the Olympia bank in such rotten shape that you re-wrote all the books that could be re-written?*

A. *In the ledger I didn't use the accounts here* [*there*] *at all.*

Q. *That is because you found them in such bad shape you couldn't put any dependence on them?*

A. *Yes, I took my records from the cash book entirely.*"

In other words, Receiver McKinney himself says that the original entries, which he found reliable, showed this as an apparent charge to Tenino, while only an utterly unreliable ledger, kept by Hays, showed these items as charged to us.

Plaintiff, himself a banker, says on this point (Supp. Tr. p. 39):

"Q. You do not find, do you, Mr. McKinney,

in the books and records of the Olympia bank anything justifying the finding or the charge of any of those Tenino accounts against the United States National Bank?

A. On the books of the Olympia Bank & Trust Company?

Q. You find nothing that would justify from the books,——

A. There is nothing on my records to show that they should be charged to Centralia.

Q. Or anywhere else that you know of?

A. No, sir. I might modify that a little bit, only that they were charged by Mr. Hays on the books to Centralia. I would change that answer a little bit.

Q. *You don't find anything such as you would ordinarily find in the records of a bank, such as would ordinarily exist before the proper charge could be made, to justify such charges?*

A. *No.*

Q. *On the contrary, such records as you find indicate that those items should be charged to the Tenino bank,* Seattle bank, *and not to the Centralia bank?*

A. *Tenino bank.*"

On re-examination by his own counsel, Mr. McKinney says (Supp. Tr. p. 40):

"BY MR. TROY: In answering counsel as you have, have you taken into account the correspondence you testified to in your direct examination, the various letters that you referred to, and receipts?

A. Yes, for those three items I think I have. They do not connect the Centralia bank with the —there is nothing there to show that I can see connecting them up directly.

BY THE COURT: That refers to the $10,000?

A. Yes, sir, the three items."

Mr. Hays testifies:

*First.* That Gilchrist told him to charge one of the $2,000.00 remittances to him (Supp. Tr. p. 100). This is misstated in the transcript, p. 74, so as to make witness say that Mr. Gilchrist told him to charge the United States National Bank. We think Mr. Hays seems a little uncertain about this, though, for on p. 103 Supp. Tr. he is asked: Q. "You said he called you up on the morning of the 19th, then, that must have been a mistake." A. "I don't know. I know he called me up every day, not all the time. I don't know about this transaction though." On cross-examination, however, *Hays squarely admits that Gilchrist did not tell him to charge the item in any particular way,* finally stating the matter as follows (Supp. Tr. 147):

> "Q. Now, turning a moment to the Tenino transaction, Mr. Hays, did you from time to time, or at any time, receive any telephone communication from Mr. Gilchrist regarding sending funds to Tenino?
>
> A. I did.
>
> Q. Those were simply calls on the 'phone from you to Mr. Gilchrist under the situation which you have already explained as to your various relations with Gilchrist and with the Tenino bank?
>
> A. Yes, sir.
>
> Q. In which Gilchrist told you that it was necessary that you send some money to Tenino?
>
> A. Yes.
>
> Q. *He didn't undertake to tell you how you should do it or from what funds you should do it, or how or who you should charge it to,* but simply

said there was so much needed by Tenino at that time, is that it?

A. *Yes, sir.*"

Mr. Gilchrist makes the whole matter clear as follows (Supp. Tr. 489, 490) (Cf. Tr. 130):

"* * * Mr. Blumauer called up, as he did frequently in connection with their affairs, called attention to the fact that their drafts were going to protest in Seattle and it was absolutely necessary that finances be transferred there to cover. I told him that I would take the matter up with Mr. W. Dean Hays and called his attention to the necessity of protesting those drafts immediately. I called Mr. Hays on the phone and told him of the situation and told him to — it was *"up to him"* to see that those drafts were protected and at once, and he apparently sent the remittance referred to to Seattle and *charged it to the United States National Bank of Centralia without any authority from us whatever.*

Q. Is that all you know of the Six Thousand Dollar transaction?

A. That is all I recall.

Q. Then please state, Mr. Gilchrist, everything that you know regarding each of the two Two Thousand Dollar transactions with the Tenino bank.

A. The other two transactions were practically similar."

Your honors will note that the summary of this testimony (Tr. 114) omits the vital parts:

(a) That witness told Hays, "it was up to him to see that those drafts were protected";

(b) That Hays charged the remittance to the

Centralia bank "without any authority from us whatever."

George Dysart, a member of the Washington Bar of high standing and one of the innocent directors of the United States National Bank, testifies (Supp. Tr. 460):

"Q. Do you know, Mr. Dysart, anything of any transactions of the United States National Bank with the Bank of Tenino?

A. Well, I know of one.

Q. Do you know anything of a $2,000 transaction which has been referred to in evidence already given in this trial?

A. Yes, sir.

BY MR. OWINGS: Now, I would like to know what $2,000 you refer to?

BY MR. GOODALE: We will bring it out as soon as the witness can answer.

Q. What is the transaction you refer to?

A. The morning of September 18, 1914, it was Friday morning, I was in the United States National Bank with the United States National Bank Examiner, Mr. Mult, and I got a 'phone call from the State Bank of Tenino. Mr. Isaac Blumauer was talking. He said that he didn't have enough to run on during the day. I asked him if he was taking deposits and he said he was, and I said, 'You are going to have trouble if you can't take care of your business and are taking in deposits.' He wanted $2,000 sent down, and I didn't know the relations between the two banks, and I asked Mr. Mult and he said, 'They are into us enough now. Don't send them any more money.'

BY MR. VANCE: I object to this conversation with other people when we were not present.

BY THE COURT: The objection may be overruled.

BY MR. VANCE: Exception.

A. I then told Mr. Blumauer that we couldn't send any money and wouldn't send him any; *that he should call up Mr. Hays; that it was his bank, and for him to look after it.* I didn't see Mr. Blumauer until about five o'clock that night. He came down and I asked him how he got through, and he said that he called up Mr. Hays and told him the condition it was in and he said he would immediately send him $2,000. * * *

Q. You never in any manner requested that any funds be sent from the Olympia Bank to the Tenino bank?

A. Never did."

Even Mr. Blumauer, whose animus is evidently strongly against appellee, says as to those charges (Supp. Tr. p. 117, line 13):

> "I had to credit it to one or the other (the Olympia bank or the United States National Bank) without any instructions. I knew it would be straightened out between Mr. Gilchrist and Mr. Hays."

While Receiver Langley, of the Tenino bank, testifies (Supp. Tr. 54):

> "Q. Well, I simply wanted to know if there was anything on the face of the record anywhere to indicate the connection of the U. S. National with this $2,000 item on the 19th inst. that you found.
>
> A. No, sir."

Such entries as are made by the Tenino to the credit of U. S. National in this connection Langley explains may readily have been caused by *Hays,* for his own purpose (Supp. Tr. 59).

On this testimony we are content to submit the issue of the remittance to Tenino to the Court without further argument.

Admittedly, there was every reason why Mr. Hays, as principal owner of the Tenino Bank should individually supply funds to meet its needs.

Admittedly, the United States National Bank by its Vice-President, Mr. Dysart, refused to send funds.

Admittedly, funds were sent by the Olympia Bank through the action, rightful or wrongful, of Mr. Hays, its cashier.

Admittedly, this action was taken without other request from Mr. Gilchrist than a telephone demand.

Admittedly, the U. S. National never sent a letter of confirmation, such as would have been customary if the remittance had been requested on the credit of that bank.

Admittedly, the Olympia Bank never notified the United States National Bank that it was even attempting to charge the Tenino remittance to it (Supp. Tr. 36, 37, 149, l. 15), though confirmation or report of such charges is universally customary.

Neither such remittances nor any charge against the United States National Bank on account of them were mentioned in letters sent by the Olympia Bank to the United States National on the very day of such

transfer, though other transactions of that day are set forth (Supp. Tr. 36, 37).

Hays finally says that Gilchrist simply asked him to remit without telling him to charge the item either to the Tenino Bank, to the United States National Bank, to Mr. Hays, himself, or to Mr. Gilchrist, and Gilchrist testified squarely *that he told Hays, as did Dysart, that the matter was "up to him" and that he, Hays, individually would have to look after the needs of the Tenino Bank* (Supp. Tr. 490, 534).

We submit that the decree of the Trial Court was right and that the only finding justified by the foregoing evidence is that the United States National Bank never authorized the Tenino remittances to be charged to it and that Hays, conscious that such was the case, concealed from appellee bank the fact that in the Olympia Bank ledger he was entering these items to our debit for the purpose of misleading his own board of trustees regarding the remittances which he was making for his own personal benefit as owner of the Tenino Bank.

## ARGUMENT ON THE APPEAL OF LANGLEY, RECEIVER OF STATE BANK OF TENINO.

The question of the power of this receiver to maintain the present action is elsewhere discussed (p. 83). We will now take up in detail the facts involved in

Langley's appeal. There are two transactions, or rather series of transactions, to be considered. They are:

(a) The matter of the Blumauer Lumber Company drafts.

(b) The W. Dean Hays five thousand dollar note.

We will discuss these in order.

(*a*)

*The Blumauer Lumber Company Drafts.*

The appellant finds it difficult to find grounds upon which to base a complaint with respect to the ruling of the lower court upon this matter. The facts as presented even by the appellant are, we believe, sufficient to answer in the affirmative the query, stated on page 62 of appellant's brief, as to whether the facts as stated by him are as a matter of law sufficient to release the United States National Bank from liability. We call attention, however, to a few additional facts.

The Blumauer Lumber Company was a borrower from the Tenino Bank (Tr. 88) as well as from the United States National Bank. Mr. Gilchrist testifies (Tr. 115) that the State Bank of Tenino arranged for a line of credit with the Merchants' National Bank of Portland, covering three or four thousand dollars, by putting up notes of the Blumauer Lumber Co. This was rediscounted paper *and the Tenino Bank was liable*

*on it,* presumably as endorser (Supp. Tr. 560). When these notes became due the Merchants' National Bank was insistent that they be taken up. The plan was then devised (Tr. 116), of paying a part of the account and renewing the balance. Various drafts, aggregating $2,500, were sent by the Tenino bank to the Portland bank, drawn upon the United States National. Gilchrist was to "protect the drafts when they came in, in the ordinary course of business notwithstanding their account at that time, and *that is the only connection witness had with the transaction"* (Tr. 116). Gilchrist testifies (Tr. 116) that he was aware of the fact "that there had been permitted for a long time by the State Bank of Tenino a large loan of credit, and by the Blumauer Lumber Company for whose benefit those particular drafts were issued, and that there was a business relationship there with the State Bank of Tenino by which they seemed ready to extend a large amount of credit."

The drafts which were issued were in the ordinary form (Tr. 116). They directed Centralia to pay Portland and charge Tenino (Supp. Tr. 397, 398). *They therefore constituted upon their face an authorization from the Tenino bank to the Centralia bank for the latter to charge the Tenino bank's account with the amount of the drafts,* and that was what was in fact done. Three of them were executed by Mr. Blumauer

as president of the Tenino bank and the other one by Mr. Hays as cashier (Tr. 85). Surely it would require clear and satisfactory testimony to vary this written authorization from the Tenino bank, yet there is nothing to contradict the plain tenor of the drafts except the vague and uncertain statements and "understandings" of Hays and Blumauer (Tr. 85) that the United States National Bank was in some way to "stand behind" the Tenino bank in the transaction (Tr. 98). Observe that these drafts *were in payment of Tenino's own indebtedness to Portland* (Supp. Tr. 580).

Mr. Gilchrists' testimony is very clear to the effect that there was no agreement on his part that this additional $2,500 of Blumauer indebtedness should be saddled onto the United States National Bank. He had a very good reason for not wishing to carry this additional indebtedness in that the Blumauer Lumber Company was then indebted to the United States National Bank up to the legal limit (Tr. 85). He would therefore have every reason for wishing to avoid making any further loans, either directly or indirectly, to the Blumauer Company. We are quite unable to see the fraud which the appellant contends the court must find in order to support Gilchrist's version of the transaction.

It seems thus that the fraud would be imputed

rather by accepting appellant's version of the transaction, for appellant argues that the parties colluded to deceive the bank examiner and effect a fraud upon the laws of the United States relative to excessive loans, by making an excessive loan, but concealing it in such a way that it would seem to be the indebtedness of the Tenino bank.

We have to consider the testimony only of Gilchrist and Blumauer in regard to these drafts. The incompetency of Hays' testimony is disclosed by the following, occurring on p. 395 of the Supplemental Transcript, but omitted from the printed transcript:

> "Q. (By Mr. Owings) Well, was there any arrangement whereby the United States National was to really stand behind this draft?
> A. Yes, sir.
> Q. Or do you know about that of your own knowledge? Did you have a discussion with Mr. Gilchrist or any of the officers of the bank in regard to it?
> A. No.
> Q. Whatever information you have in regard came through Mr. Blumauer?
> A. Yes."

We have here presented then only such inconsistencies as Blumauer's and Gilchrist's testimony may show. Gilchrist is sustained by the drafts themselves and, as it seems to us, by all the probabilities of the case.

We do not find, however, any necessary irreconcilability between the versions of Blumauer upon the

one side and Gilchrist upon the other. Blumauer testifies (Tr. 85), "Mr. Gilchrist said he would take care of this loan." Blumauer was "to issue drafts on Centralia and Gilchrist was to take care of them" (Tr. 84). Mr. Gilchrist says (Tr. 116) that he told the Tenino bank he would protect the drafts when they came in, in the ordinary course of business, notwithstanding the condition of their account at that time; that the drafts were to be charged to Tenino (Tr. 123). He had no knowledge of the non-payment of the drafts to Tenino by Blumauer (Tr. 116) and supposed Tenino was looking to Blumauer as in other cases (Tr. 117). The drafts and cancelled vouchers were returned to Tenino (Tr. 123) and the charges apparently were not questioned by it.

This testimony of Gilchrist's, we think, furnishes the reasonable explanation of the apparent misunderstanding between the parties, and goes far towards reconciling their accounts of the transaction. The Centralia bank was to "stand behind" the drafts (Tr. 98) to the extent of seeing that they were paid, regardless of the condition of the Tenino bank's account in the U. S. National Bank.

The Centralia bank did carry out its agreement, it did pay the drafts, and that is as much as we believe it can possibly be found, under the testimony here, that it ever agreed to do. Thus the Blumauer Lumber

Company, a customer and debtor of the Tenino bank, was accommodated, and the Tenino bank was enabled to preserve its credit with the Portland bank through taking up the notes of the Blumauer Lumber Company which it had deposited with the Portland bank as a basis of securing credit (Tr. 115), and upon which it was liable.

Appellant tries to show that the Centralia bank derived some benefit from this transaction, but such is not the case. It may have had some indirect interest in Blumauer's credit being sustained (though this interest was not so great as appellant supposes. Supp. Tr. 514), but so had the Tenino bank, for the same reasons (Tr. 116).

If, as appellant contends, the Centralia bank was in effect lending its credit for the benefit of the Tenino bank, or of the Blumauer Company, then the case falls within the principle of the authorities already cited (Ante p. 14), and the Centralia bank incurred no liability. And the fact that the purpose may have been to aid someone largely indebted to the bank is immaterial. *Johnston vs. Charlottesville National Bank,* Fed Case No. 7425. That is indeed the usual situation when a bank attempts to lend its credit.

We submit that under the *facts,* the Centralia Bank never purported to assume any obligation with respect to these drafts, further than to pay them, which

was done. And that under the *law,* any such agreement as appellant contends for is *ultra vires* and void, that it would be the right and duty of the Centralia Bank to repudiate it, and that if appellant proves his case on the facts he at the same time proves himself out of court on the law.

Further, the facts as construed by plaintiff would place Gilchrist in the position of attempting to relieve parties with whom his bank was dealing from their liability upon negotiable paper—a thing which an officer of a bank has no authority to do.

See note, 28 L. R. A. N. S. 511 and 501; 3 R. C. L. 442.

(*b*)

*The Hays' Five Thousand Dollar Note Transaction.*

Prior to July 24th, 1913, Hays, who was then cashier of the Tenino bank, had a $2,000 note in the Centralia bank which the bank had been carrying for a considerable time, and had been insisting upon Hays taking up (Tr. 117). In a letter to Gilchrist on the date mentioned (defendant's Exhibit D, Tr. 177), Hays makes Gilchrist the proposition of giving another note for $5,000 secured by stock in the Tenino bank, of which amount $3,000 was to be placed as a special deposit to the credit of the State Bank of Tenino, which the Tenino bank would not draw against. Gilchrist

testifies (Tr. 117) that the loan was finally made to the best of his recollection in November (1913), with the understanding that $3,000 of the amount should remain as a special deposit for the State Bank of Tenino, which the Tenino bank was to maintain until the note was liquidated. The $2,000 note was sent to Tenino and credited to the Tenino bank's account, and the statement was rendered and reconciled (Tr. 118, 119). The $5,000 note came down to the Centralia bank in the ordinary course of business with other notes from that bank and was credited to the State Bank of Tenino on November 25, 1913 (Tr. 119, 141). It was plainly Gilchrist's understanding that both the original and renewal notes were the obligations of the Tenino bank (Tr. 120). The fact that there was no endorsement of the Tenino bank on the note can hardly be deemed material since the two banks were in the habit of handling similar unendorsed paper in the same manner (Tr. 120). Mr. Gilchrist is positive as to this being the obligation of Tenino (Supp. Tr. 511, top). It appears that the Tenino bank did not keep its agreement to maintain a special deposit of $3,000 with the United States National Bank, but that the account fluctuated back and forth as it had always done (Tr. 120).

The Tenino bank *did not question the right of the Centralia bank to charge the $5,000 note* to its account

when it was first returned to Tenino (Tr. 121), on July 15, 1914 (Tr. 142), but after keeping it for some time, returned it with the request that the Centralia bank keep it temporarily, as Gilchrist explains it, so that Hays could get his books straightened up when anticipating a visit from the bank examiner. The note was then immediately again returned to Tenino (Tr. 121), on July 24, 1914 (Tr. 142).

The court will note the very significant fact which is not clearly brought out in the printed transcript, but appears in the supplemental transcript, p. 597, that the *interest* on this note, amounting to $133.13, was allowed to remain as a charge against the Tenino bank from the date of July 16, 1914, when the note was first sent back to Tenino. This interest is not now in dispute as Mr. Hill testifies (Tr. 597). The receiver of the Tenino bank has made no complaint in regard to it either in the lower court or here. If the plaintiff's contention as to the impropriety of charging this note against the Tenino bank is sound, that impropriety extends to the charge of the *interest* as well as the *principal*. Yet the Tenino bank seems to have allowed the charge as to the interest without any question. This must be held as showing that the reason that they returned the note and did not at that time credit the Centralia bank with it is not that Tenino supposed Centralia was not *entitled* to credit, but that the return of it and the withholding of credit from Centralia were due

to the reasons stated by Mr. Gilchrist. The Tenino bank seems content to ratify a part of the transaction but tries to repudiate the remainder. This cannot be done.

Mr. Gilchrist testifies positively (Tr. 497) that the State Bank of Tenino never made any objections or protest whatever against the charging to them of either of the Hays notes. *This charging back was in accordance with a custom existing between the two banks to charge back paper which turned out to be bad, or depreciated in value* (Supp. Tr. 125). And is in fact according to the usual custom among banks. Hays' testimony tends to support Gilchrist's upon the point that the Tenino bank did not dispute its liability upon the note when he states (Tr. 77) that the Tenino bank "refused payment of it (the $5,000 note) and returned it to the United States National Bank of Centralia with a statement of explanation that Mr. Gilchrist was going to buy witness' stock in the State Bank of Tenino, and would take up that note and pay the difference." That is, the reason the note was returned was not on account of any denial of liability of the Tenino bank on it, but was because they thought they saw a way to get the note paid by the maker. Plaintiff Langley himself testifies (Tr. 110) that he has no evidence that the Tenino bank disputed the item. The fact that the note was not entered in any way on Tenino's books is

not at all conclusive as Mr. Langley himself explains (Tr. 110).

The fact that the note was on the form used by the Centralia bank is not significant and is fully explained by Mr. Gilchrist (Tr. 120).

The material facts, in reference to this note, may be summarized as follows:

The Centralia bank has a $2,000 note of Hays', which it has received through the Tenino bank in the ordinary course of business, and which, though possibly not endorsed by Tenino, was precisely similar to numerous other notes which the banks in their previous dealings had recognized as obligations of the Tenino bank. Hays failing to pay it, it is renewed (Tr. 134) by Hays giving a $5,000 note which is remitted to the Centralia bank through the Tenino bank, and placed to the credit of the Tenino bank in the same way as any other renewal note would have been credited, except that here the renewal note was for a larger amount than the original note, and this additional amount of $3,000 the parties agreed should be carried as a credit, not to Hays, but to the Tenino bank. In course of time, when the renewal note was not paid, the Centralia bank returned the note as it would have returned any other overdue paper. This was in accordance with a custom between the two banks with respect to such paper (Supp. Tr. 125). The ap-

pellant's complaint with respect to the action of the lower court seems to be that the $3,000 credit was drawn out and used by Hays for his own private purposes. But there is no evidence, and it is not even contended that the United States National Bank had any knowledge of any misappropriation which Hays may have made. In fact, as Hays himself testifies, he drew the money *out of the State Bank of Tenino* (Tr. 80). Hays may have drawn money from the Tenino bank which *he* thought was to be charged by the Centralia bank against this particular credit. Gilchrist says that the credit was to the Tenino bank and not to Hays, and the note was undoubtedly carried by the Centralia bank to the general credit of the Tenino bank, and was finally charged to the Tenino bank the same as any other overdue and unpaid item would have been.

If Hays was misapplying funds of the Tenino bank, we of course would not be affected by it so long as we had no notice. *Goshen National Bank vs. State,* 36 N. E. 316 (New York).

The evidence shows, we think, *first,* that the Centralia bank had a right to charge back this note to Tenino; and, *second,* that it exercised that right and its exercise was concurred and acquiesced in by the Tenino bank before the insolvency of either.

Upon this branch of the case, we submit that the decree of the lower court was right both as to the Blu-

mauer Lumber Company drafts and as to the Hays note, and that it should be in all respects affirmed as to the receiver of the Tenino bank.

## APPELLANTS NOT ENTITLED TO PREFERENCE.

As to the suggestion that the plaintiff McKinney or the intervenors are entitled to a preferred claim against the appellees, this could be sustained only by proof of the following facts:

(a) That there was a relation of trustee and *cestui que trust* and not merely of *debtor and creditor* between the two banks.

(b) That there was a trust fund *which actually came into the possession* of the Centralia bank.

(c) That this trust fund was traced into the assets *which came into the receiver's possession* upon insolvency, and

(d) That appellants are entitled to such trust fund as against other claimants of a right to preference.

Not the slightest effort is made by the appellants to establish any of these essential and fundamental propositions. This matter of trust funds has recently been before this court in *Titlow vs. McCormick,* 236 Fed. 209, decided September 5, 1916. See also *In re*

*Acheson*, 170 Fed. 427, *Spokane County vs. First National Bank of Spokane*, 68 Fed. 979, both of which cases were decided by this court. *Schuyler vs. Littlefield*, 232 U. S. 710; *American Can Company vs. Williams*, 178 Fed. 420, C. C. A. 2d Cir.; *Empire State Surety Co. vs. Carroll*, 194 Fed. 593, C. C. A. 8th Cir.; *City Bank vs. Blackmore*, 75 Fed. 771.

## OUR OPPONENTS' BRIEFS.

We have perhaps already sufficiently answered our opponents' arguments, but on account of the complicated nature of the case, think it advisable to refer to them again briefly in certain particulars.

*As to appellant McKinney's brief.* This appellant's conception of the facts differs fundamentally from our own. We do not deem it necessary to discuss the applicability of the authorities which he cites to the theory which they are claimed to support, as there is nothing, we believe, in the facts upon which that theory can be predicated. Our contention is that there was no payment of Hays' obligations with funds of the Olympia Bank & Trust Company, but merely a cancellation by the United States National Bank of a credit which was fraudulent and void from the beginning as against the creditors and stockholders of that bank.

As to the complaint made by appellant McKinney (p. 35 to 39, appellant's brief) in regard to the return

of Olympia stockholders' notes. He is, as we have previously pointed out, not in a position to urge this claim, as the intervenor appellants, who were at the request of McKinney's counsel and upon his representation that there was no conflict between intervenors and plaintiff, represented at the trial by the same counsel who appeared also for plaintiff, *asked and received in open court* before the conclusion of the trial the very notes of whose return receiver McKinney now complains. (Supp. Tr., p. 586.)

*As to appellant Langley's brief.* We have, we believe, sufficiently answered this appellant's arguments under our previous discussion of the appeal of the receiver of the Tenino bank.

*As to the appellant intervenors,* We cannot attempt to correct all of the inaccuracies of this brief without restating it *in toto.* It seems to us that nearly all of the material statements in it are wrong, as the record and particularly the supplemental transcript will show, although we do not wish to be understood as charging counsel for the intervenors with any bad faith or desire to mislead the court.

We protest against the statements outside the record, too numerous to mention here, contained in intervenors' brief, and against their unqualified and incorrect statement (Intervenors' brief, p. 5) that Hays *sold* his bank in Tenino to Gilchrist, "or to the United

States National Bank." The suggestion that the appellee, United States National Bank, purchased the Tenino bank of Hays is wholly untrue and unsupported by any testimony whatever. It finds no support even through error in the printed record, while the statement that Hays had sold his bank is shown to be untrue by the admissions of Hays himself, as well as of Gilchrist, contained in the typewritten transcript of the testimony, but omitted from the printed record and commented upon elsewhere in this brief (Supp. Tr., pp. 64-65).

Next intervenors (pp. 6 and 7, their brief) give, we think, a mistaken impression as to the origin of the plan to start the Olympia bank, by omission of reference to the testimony, called attention to by comment and inquiry of the trial court, and omitted in condensed statement of the evidence, to the effect that Hays first took this matter up with Gilchrist at Centralia, and at that time told him that he was going to sell his Tenino bank and start a bank in Olympia. It was Hays' plan, not Gilchrist's. (Supp. Tr., p. 525.)

All reference to the fact that intervenors as officers of the Olympia bank, in order to lawfully start business must have themselves *made affidavit that the stock had been paid in cash,* is omitted.

The omissions in the testimony quoted by intervenors are very glaring. For instance, at the top of

page 12, intervenors' brief, will be seen the statement, "He was subscribing for it in his personal capacity." This statement is made in the condensed statement of evidence and in the brief without the slightest mention of the striking qualification which the witness embodies in his answer, and which changes the whole meaning. It is taken from page 522 of the certified statement of evidence, where the actual testimony appears as follows:

> (Cross-examination of Witness Gilchrist.)
> "Q. He was subscribing for the stock in his personal capacity?
> A. Yes, you might say he did subscribe for it individually as his name appears, *but with the instruction of the board of directors.*
> Q. He told you then that he subscribed for the balance of the stock under the instructions of the board of directors?
> A. After a thorough understanding, yes."

Similarly inaccurate condensations of testimony are so numerous that to refer to all of them would extend our brief beyond all reasonable limits of endurance of the court. On the same page occurs another statement from the condensed record which is most unfortunate. Gilchrist is there quoted as saying:

> "Mr. Hays told me that he subscribed for $36,550 worth of stock personally; I had no means of knowing it except what he told me. I never had any dealings with anyone with reference to the $48,000 worth of notes or to the $50,000 worth of credit at the United States National Bank except with Mr. Hays."

The testimony from which this testimony is condensed appears on page 548 of the complete or supplemental transcript of the testimony, and is as follows:

"Q. Then the credit which the United States National Bank gave on account of these two Hays' notes are a personal credit to Mr. Hays secured by the notes and the stock—evidenced rather by the notes, and secured by the stock which was left with you afterwards as collateral?

A. *It was a credit to the Olympia Bank & Trust Company through and by the knowledge of the officials of the Olympia Bank & Trust Company.*

BY MR. O'LEARY: I move to strike his answer, as not answering the question.

BY THE COURT: *The motion may be denied.*

BY MR. O'LEARY: Exception.

Q. Well, now, you never had any dealings with any one with reference to that Forty-eight Thousand Dollars of notes or the Fifty Thousand Dollars original credit which the Olympia Bank & Trust Company obtained, excepting with Mr. Hays?

A. No sir.

Q. Then as far as any one is concerned who was interested in the Olympia Bank & Trust Company you had no understanding with them at all?

A. The understanding I had was the knowledge, full knowledge of a meeting that took place at the organization of the bank.

Q. All that you knew about that meeting, Mr. Gilchrist, was what Mr. Hays told you?

A. Yes sir.

Q. And when you speak about the knowledge which the other officials of the Olympia Bank & Trust Company had of the transaction, you are

basing that statement only on what Mr. Hays told you about what their knowledge was?

A. I am basing my recollection of it on my statement of the facts as borne out by the statement in the minutes of the meeting in which Mr. Hays stated to me that it was with the knowledge of his associates that he was carrying out the arrangement along that line. *I don't think that counsel thinks for one minute that I would have thought of taking W. Dean Hays' notes for Thirty-six Thousand Dollars under any other conditions.*

Q. The conditions under which you took that note was because you thought he was going to in turn sell this stock that he subscribed for or most of it?

A. In the same manner that his associates thought to.

Q. Well, you don't know what his associates thought, except what he told you?

A. Well, he evidently told the truth largely, because it is in the minutes too."

Intervenors, referring to their own promissory notes, say: "The other notes held by the bank were good notes, and there was no need to worry about that." Without being so intended by intervenors' counsel, this statement in the connection in which it appears may be understood as implying some estoppel as to rescission on our part with regard to the $11,500 of intervenors' notes. The fact is, as disclosed by the record, that the notes were not good (Supp. Tr., p. 335), and that knowledge of the fact that they were held by the United States National Bank or the manner in which they have been obtained is never brought home

to the board of trustees of appellee bank. There was no power of rescission until the origin of these notes in the fraudulent transaction with Hays was discovered, as well as their mere existence. Our opponents say the directors did not repudiate the original credit, but made a counter charge through sending back the notes. The fact is that the original credit appeared simply as an innocent remittance, "R. $48,000." The manner of charging it off was quite correct. It is not the practice of banks to go back through their books and *strike out* entries relating to rescinded transactions.

The authorities cited by intervenors nearly all show on their face the reasons why, as we think, they are quite inapplicable to the facts here presented. Indeed the very quotations from these authorities included in intervenors' briefs in most cases disclose their inapplicability. For instance, on p. 25, intervenors' brief, *Cox v. Robinson,* 27 C. C. A. 120, by the terms of the language quoted limits the application of the rule stated to actions within the scope of the *ordinary course of business* of a cashier. The next case relates to *customary acts.* The next only to acts in the *legitimate business of banking. First State Bank Receiver v. Farmers Bank,* 155 Ky. 693, cited on page 26 of intervenors' brief, by the terms of the language quoted, limits the rule to cases in which the assignment is *for a*

*valuable consideration.* The next case cited is clearly inapplicable. The next relates to the rights of an *innocent holder* of a certified check, and the next to evidences of debt *in the ordinary course of business.* The foregoing are typical. So far as they apply, they certainly do not aid appellants.

As elsewhere pointed out, the $24,000 note was not in fact sold, re-discounted, or transferred to the Union Loan & Trust Company, but the whole original transaction having been fraudulent, it appears that both this note and the other Hays' note were kept out of the pouches of the United States National Bank by Gilchrist so that the transaction would not be discovered, and he says that he "charged" the note to the Union Loan & Trust Company, but the record itself proves that he is mistaken in this. (Tr. 158.) Gilchrist's contention on this point is not that he took the other note to the United States National Bank and then re-discounted it or transferred it to the Union Loan & Trust Company, but that he never put it into the United States National Bank at all. (Supp. Tr. 505.) Intervenors' statement, p. 39, their brief, that Gilchrist was an officer of Union Loan & Trust Company and had the right to put the Hays' note in that bank, and that he did so is contrary to the uncontradicted proof that he was not an officer or director of that bank (Supp. Tr., p. 531).

It is stated on page 30, intervenors' brief, "It must be assumed as a fact that Charles Gilchrist, the father of C. S. Gilchrist, the president and a director of the bank knew of it; he was in the bank as an officer of the bank and was not produced as a witness at the trial." The record shows (Supp. Tr. pp. 455, 504) that Charles Gilchrist knew nothing of the transaction.

Our opponents seek to sustain the $48,000 credit on the ground of innocent mistake on the part of Gilchrist. "The bank officers may have used poor judgment, but that goes with the business." The fact is, as incontestably proved by the record, that this is a case not of poor judgment but of bad faith and illegal and *ultra vires* acts.

Apparently disturbed by the possible legal effect of their own allegation that the Olympia Bank & Trust Company was organized through conspiracy and fraud, intervenors suggest (p.47) that this allegation was made by them through desire to compromise and a willingness "to make some sacrifice in the name of equity and fair dealing." We do not understand this to amount to a denial of the truth of the allegation referred to.

## COSTS.

Appellants finally claim that there was error on the part of the trial court in not allowing them costs. The fact is that the total amount allowed appellants

was a few dollars less than the appellee receiver had offered to allow them.

The rule applicable here is stated in 2 Foster's Federal Practice, 5th Ed., Sec. 407, as follows:

> "In equity and admiralty the award or denial of costs is always in the discretion of the court."

In view of the unfounded assertion of enormous claims against the insolvent Centralia bank which its receiver was compelled to defend against, we think it is clear that the discretion of the trial court in this particular was not abused.

*Plaintiff receivers herein not authorized to maintain the present action on account of the repeal of the statute under which they were appointed.*

The receivers, both of the Olympia Bank & Trust Company and the State Bank of Tenino, were appointed under Remington & Ballinger's Code, Sections 3303 and 3305.

Section 3303 authorizes the courts to appoint receivers for certain causes other than insolvency.

Section 3305 is the section authorizing receivership upon *insolvency*. It provides that if upon the examination by the examiner it appears that the bank is insolvent, it shall be his duty to take charge of it and ascertain its condition, and if satisfied that it cannot resume business or pay all its creditors,

> "He shall report the fact of its insolvency to the attorney general, who shall immediately upon the receipt of such notice, *institute proper proceedings in the proper court for the purpose of having a receiver appointed* to take charge of such bank and to wind up the business thereof, for the benefit of its depositors, creditors and stockholders."

Section 3306 refers to the compensation of receivers.

Section 3309 refers to the order of priority which the receiver shall follow in allowing claims.

*All the above cited sections of Remington & Ballinger's Code were expressly repealed by Capter 98 of the Session Laws of 1915,* which became effective on June 10th, 1915. This 1915 Act changes the entire procedure for liquidating insolvent banks and provides that the administration of their affairs shall be had by and under the direction of the state bank examiner, and contains no saving clause as to banks already insolvent and in course of liquidation under the former law.

Section 1 of this Act provides:

> "Whenever it shall appear to the state bank examiner . . . . . that any bank or trust company . . . . . is in an unsafe or unsound condition, or that it is unsafe or inexpedient for such bank or trust company to continue business . . . . if he shall deem necessary, he may take possession of such bank or trust company and administer the same as herein provided."

Section 10 provides:

> "No receiver shall be appointed by any court, nor shall any deed of assignment for the benefit of creditors be filed in any court within this state, for any bank or trust company doing business under the laws of this state except upon notice to the state bank examiner, unless in case of urgent necessity it becomes in the judgment of the court necessary so to do in order to preserve the assets of such bank or trust company. The state bank examiner may, within five days after the service of such notice upon him take possession of such bank or trust company, in which case, no further proceedings shall be had upon such application for the appointment of receiver or under such deed of assignment, *or if a receiver has been appointed or such assignee shall have entered upon the administration of his trust, such appointment shall be vacated* or such assignee shall be removed upon application of the state bank examiner to the proper court therefor, *and the state bank examiner shall proceed in all such cases to administer the assets of such bank or trust company as herein provided.*"

Other sections prescribe details for the administration of the trust by the state bank examiner or by a liquidating agent who may be chosen by the stockholders.

The suit of McKinney, receiver of the Olympia Bank & Trust Company, was filed February 20th, 1915. The suit of Langley, as receiver of the State Bank of Tenino was filed December 6, 1915. It will thus be seen that the McKinney suit was filed *before* and the Langley suit *after the 1915* law went into effect. This, however, we believe immaterial, since both of the re-

ceivers derive their authority from the provisions of the repealed statute.

It will be seen that the 1915 Act transferred the administration of insolvent banks from the *courts* to the *State Banking Department.* We deem it a serious question whether this had not the effect of terminating the jurisdiction of the Superior Court of Thurston County, which appointed the plaintiff receivers, over the subject matter, and as a necessary consequence of ending the authority and powers of the receivers, except to account for assets taken into their possession up to the time their authority ceased, and turn them over to the State Bank Examiner.

The authorities are clear that the repeal of the statute conferring jurisdiction or transferring jurisdiction over a particular class of actions or proceedings from one body or tribunal to a different one, has the effect of terminating the authority of the body or tribunal, which under the repealed act had jurisdiction, and leaves it without authority to take further proceedings.

For instance, in *Grand Trunk Railway vs. Board of Commissioners,* 33 Atlantic 988 (Maine), the County Commissioners, in February, 1893, instituted proceedings for the determination of the question of whether a flagman should be required at a certain railroad crossing, and on June 5, 1893, adjudged that such flag-

man was necessary. On April 28th, of that same year, a new statute had gone into effect, which conferred jurisdiction over such proceedings upon the *Railroad* Commissioners, instead of the *County* Commissioners, without any saying clause respecting proceedings then pending. It was held that the new statute deprived the County Commissioners of jurisdiction over the subject matter, and that their action of nugatory.

See also: *Remington vs. Smith,* 1 Colo. 63; *Hunt vs. Jennings,* 5 Blackf. (Ind.) 195; *French vs. State,* 53 Miss. 651; *Musgrove vs. Vicksburg & Nashville R. R.,* 50 Miss. 677; *Lamb vs. Schottler,* 54 Calif. 319; *Baltimore & Potomac Railroad Company vs. Grant,* 98 U. S. 398, 25 L. Ed. 132; *South Carolina vs. Gaillard,* 101 U. S. 433; *Ex-parte McCardle,* 74 U. S. 506.

The foregoing authorities are illustrative merely of various applications of a principle which we believe governs the case at bar, and in conclusion upon this point we submit: *First,* that the repeal of Section 3305, Remmington & Ballinger's Code terminated the jurisdiction of the Superior Court of Thurston County, over the administration of these trusts; *second,* that it revoked the authority of plaintiffs McKinney and Langley, to do any further acts in respect to the administration of these trusts, including necessarily the discontinuance of these present suits.

These contentions were raised in the court below, as page 282 of the stenographic report of the testimony shows.

It is clear that upon application of the State Bank Examiner to the Court by which appellant receivers were appointed it would under the statute above quoted be bound to interdict any further activity of receivers and to leave the State Bank Examiner free to administer the assets of these banks under the statute now in force. The only question open with regard to the matter is whether an application to and action by the Court appointing the receiver is necessary to terminate the receiver's power to pursue additional assets.

*In conclusion* we venture to assert that this Court has seldom been called upon to exercise its equitable powers for the assistance of parties who had less of equity to commend them than attends the plaintiff McKinney and the intervening stockholders.

Disregarding all technicalities and considering the case only from the broad viewpoint of what disposition of it is demanded in order to attain the ends of *justice,* the conclusion that the defendants must be exonerated from further liability in respect to these fraudulent transactions seems to follow inevitably.

On the one hand is the appellant McKinney representing, as the record shows, not creditors seeking to

retrieve losses through having placed a misguided confidence in the United States National Bank, but the negligent or fraudulent incorporators of the Olympia bank, and with the receiver those same incorporators themselves, not deterred by their own entire lack of equity from seeking a recovery where they have invested nothing and have sustained no loss; on the other hand, the defendant receiver representing some three thousand innocent persons, against whom no wrong can be imputed and who in justice are entitled to demand that their already heavy losses may not be increased by the imposition of burdens arising through any attempted embarkation by the defendant bank in enterprises beyond the scope of its legitimate powers and in fraud of the laws under which it had its existence.

Respectfully submitted,

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